

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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In the Matter of )

Extension Of Section 272 Obligations )  
Of Southwestern Bell Telephone Co. )  
In The States Of Kansas and Oklahoma )

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WC Docket No. 02-112

**REPLY COMMENTS OF AT&T CORP.**

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## **TABLE OF CONTENTS**

INTRODUCTION AND SUMMARY .....	1
ARGUMENT .....	4
I. THE COMMENTS CONFIRM THAT THE SECTION 272 SAFEGUARDS REMAIN CRITICALLY IMPORTANT IN KANSAS AND OKLAHOMA. ....	4
A. The Record Is Clear That SWBT Possesses Market Power And That Retention Of Section 272 Safeguards Is Necessary To Promote Competition In Kansas and Oklahoma... ..	4
B. The Record Is Clear That SWBT Continues To Misallocate Costs And Discriminate Against Unaffiliated InterLATA Competitors. ....	8
II. SBC FAILS TO OFFER ANY PLAUSIBLE JUSTIFICATION FOR SUNSETTING CORE SECTION 272 SAFEGUARDS.....	11
A. The Commission’s Decision To Allow The Section 272 Safeguards To Sunset In New York and Texas Does Not Provide A Basis For Sunsetting Such Obligations On SWBT in Kansas and Oklahoma.....	11
B. SBC’s Claims That Section 272 Safeguards Are Too Costly Are Contrary To Theory And Fact.....	12
1. The Evidence in the <i>OI&amp;M Proceeding</i> Shows that Carriers Like BellSouth Incurred Only Minimal Costs in Complying with Section 272. Any SBC or Verizon Claim of Higher Costs Reflect Inefficiency or Methodological Errors .....	12
2. SBC Has Told Wall Street Analysts And Investors That It Can Fully Compete For All Customers, Including Enterprise And Broadband Customers, Under The Current Regulatory Regime.....	14
3. The Commission Has Already Minimized the Burden on the BOCs .....	15
C. The Existence Of Other Regulatory Protections Is Not A Reason To Sunset Section 272.....	17
CONCLUSION.....	19

## GLOSSARY OF COMMISSION ORDERS

SHORT CITE	FULL CITE
<i>Access Reform Order</i>	First Report And Order, <i>Access Charge Reform et. al.</i> , 12 FCC Rcd. 15982 (1997)
<i>Ameritech-SBC Merger Order</i>	Memorandum Opinion And Order, <i>Applications Of Ameritech Corp., Transferor, And SBC Communications Inc., Transferee, For Consent To Transfer Control Of Corporations</i> , 14 FCC Rcd. 14712 (1999)
<i>Bundling Order</i>	Report and Order, <i>Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(G) of the Telecommunications Act of 1934, As Amended</i> , 16 FCC Rcd. 7418 (2001)
<i>Forfeiture Order</i>	Forfeiture Order, <i>Matter of SBC Communications, Inc</i> , 17 FCC Rcd. 14712 (2002)
<i>Kansas/Oklahoma Section 271 Order</i>	Memorandum Opinion and Order, <i>In the Matter of Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma</i> , CC Docket No. 00-217, 16 FCC Rcd. 6237 (2001)
<i>LEC Classification Order</i>	Second Report and Order, <i>Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area</i> , 12 FCC Rcd. 15756 (1997)
<i>Non-Accounting Safeguards Order</i>	First Report and Order and Further Notice of Proposed Rulemaking, <i>Implementation of Non Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended</i> , 11 FCC Rcd. 21905 (1996)
<i>Non-Dominance FNPRM</i>	Further Notice of Proposed Rulemaking proceeding in FCC WC Docket No. 02-112 and CC Docket No. 00-175, FCC 03-111 (rel. May 19, 2003)
<i>SBC OI&amp;M Proceeding</i>	<i>Petition of SBC for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) and 52.203(a)(3) of the Commission's Rules and Modification of Operating,</i>

SHORT CITE	FULL CITE
	<i>Installation and Maintenance Conditions Contained In the SBC/Ameritech Merger Order</i> , CC Docket No. 96-149, 98-141
<i>Sunset NPRM</i>	Notice of Proposed Rulemaking, <i>Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements</i> , WC Docket No. 02-112 (rel. May 24, 2002)
<i>Texas Section 272 Extension Proceeding</i>	<i>Extension Of Section 272 Obligations Of Southwestern Bell Telephone Co. In The State Of Texas</i> , WC Docket No. 02-112; <i>Public Notice</i> , 18 FCC Rcd. 13566 (2003)
<i>Verizon OI&amp;M Proceeding</i>	<i>Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules</i> , (“ <i>Verizon Forbearance Proceeding</i> ”) CC Docket No. 96-149

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**REPLY COMMENTS OF AT&T CORP.**

AT&T Corp. (“AT&T”) respectfully submits these reply comments in support of its Petition requesting that the Commission extend application of the separate affiliate and other safeguards of 47 U.S.C. § 272 to Southwestern Bell Telephone Co. (“SWBT”) in Kansas and Oklahoma for an additional three years.

**INTRODUCTION AND SUMMARY**

In its Petition, AT&T showed that Congress intended the “crucial[ly] important[.]”<sup>1</sup> section 272 safeguards to remain in effect until a Bell operating company (“BOC”) has lost its ability to exercise market power. AT&T has thus sought such an extension in those states where the data in the record demonstrates that this standard has been met. This is certainly the case in Kansas and Oklahoma. AT&T has shown in this proceeding that SWBT continues to enjoy overwhelming market power in Kansas and Oklahoma today, and will for the foreseeable future, and because it has the incentives and ability to misallocate costs and discriminate against

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<sup>1</sup> *Kansas/Oklahoma 271 Order* ¶ 256.

unaffiliated competitors, there could be no reasoned basis for now eliminating existing section 272 obligations.

SBC Communications Inc. (“SBC”), SWBT’s parent, in its comments filed in response to AT&T’s Petition, argues that it no longer has market power in Kansas and Oklahoma. To do so, SBC mischaracterizes and then dismisses the Commission’s most recent report (reviewing data through December 2002) showing only limited, and stagnant, local competition through 2002. Indeed, SBC now claims that local competition is increasing in Kansas and Oklahoma, proffering its gerrymandered “market share” data derived not from public verified sources, but from SBC’s self-serving “E 911 methodology.” But those arguments fly in the face of public representations that SBC made to Wall Street analysts and investors that local competition in Kansas and Oklahoma has materially *declined* in 2003.

SBC also attempts to sweep aside the mounting evidence showing that SBC and its BOC subsidiaries are using their local bottlenecks to discriminate systematically against rivals – and, therefore, that in the absence of section 272 safeguards that SBC would have even greater ability to exclude competitors and raise their costs. SBC derides this evidence as the “half-baked” complaints of competitors,<sup>2</sup> but AT&T’s Petition relies principally on findings by auditors and state and federal regulators. For example, SBC has been penalized *over \$1.1 billion* by federal and state regulators as a result of its pervasive violations of provisions of the Communications Act, merger conditions, and section 271 conditions designed to prevent SBC from discriminating against its rivals. Likewise, the work product from SBC’s own hand-picked auditors demonstrates that SBC has persistently provided its long distance rivals with network access that is manifestly inferior to the access it provides to its own long distance affiliate.

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<sup>2</sup> SBC at 9.

Unable to rebut this evidence that SWBT is dominant and has, in fact, abused its market power, SBC falls back to its shop-worn arguments: (1) that the section 272 safeguards should be eliminated because other safeguards, present in 1996 when Congress mandated the Section 272 safeguards, are sufficient protection despite SWBT's conceded market power; and (2) that these safeguards hobble SBC's ability to compete in long distance markets. SBC's recent statements to the investment community should put these claims to rest once and for all. SBC told investors that SWBT has already captured between 50% and 60% of the residential long distance market in Oklahoma and Kansas – a level of success that no other long distance competitor ever achieved.<sup>3</sup> Whatever “burdens” section 272 imposes on SBC, and they are relatively modest, one thing is clear: existing section 272 obligations did not prevent SBC from having quickly become the dominant long distance provider in its local territories. Indeed, SBC's experience only confirms the need to strengthen, rather than abandon, existing protections against discrimination and cross-subsidization.

AT&T does not, as claimed by Verizon, seek “to handicap its BOC competitors,”<sup>4</sup> nor does it, as claimed by SBC, seek to “raise the costs of its rivals” subjecting them to constraints “to which AT&T is not subject.”<sup>5</sup> To the contrary, extension of the section 272 safeguards is necessary in Kansas and Oklahoma to ensure that the BOCs compete on a *level playing field*, placing BOCs and their affiliates in the same position as their competitors in the local and interLATA markets. Moreover, the need for a level playing field is as necessary in the business market as in the residential market because SBC and the other BOCs maintain a firm

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<sup>3</sup> AT&T Reply Comments, Non-Dominance FNPRM at 27, MCI Comments, Non-Dominance FNPRM at 2 (it took all non-AT&T IXC's more than ten years to achieve more than 30% collectively following the 1985 beginning of equal access).

<sup>4</sup> Verizon at 1.

<sup>5</sup> SBC at 1.

monopolistic grip on critical inputs in the business market, such as for the provision of special access.

As the record shows, even three years after SBC's markets in Kansas and Oklahoma were deemed to be open to the *possibility* of competition, SBC retains the market power that the Commission has long recognized necessitates the unique § 272 requirements – including structural separation, detailed audits that could (and did) reveal misconduct, and accounting, transactional and nondiscrimination safeguards – that were expressly designed to allow the Commission and state regulators to monitor the competitive landscape, detect and deter market power abuses, and ensure that competition in long distance occurred on a level playing field. Thus, the Commission should grant AT&T's Petition to retain the section 272 safeguards in Kansas and Oklahoma for at least another three years.

## **ARGUMENT**

### **I. THE COMMENTS CONFIRM THAT THE SECTION 272 SAFEGUARDS REMAIN CRITICALLY IMPORTANT IN KANSAS AND OKLAHOMA.**

#### **A. The Record Is Clear That SWBT Possesses Market Power And That Retention Of Section 272 Safeguards Is Necessary To Promote Competition In Kansas and Oklahoma.**

As AT&T has demonstrated, both in the *Sunset NPRM* and in the *Texas Section 272 Extension Proceeding*, Congress intended that the Commission extend the section 272 safeguards where the BOC retained local market power in the manner that SBC has in both Kansas and Oklahoma.<sup>6</sup> That is, Congress adopted the section 272 safeguards in recognition of the fact that, upon receipt of section 271 authorization, a BOC's local markets in a state will be merely "open" to competition and that some time will necessarily pass before competition sufficient to constrain

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<sup>6</sup> See AT&T Petition at 2-4, WC Docket No. 02-112 (filed Dec 8, 2003) ("AT&T Petition").



the exercise of market power by the BOC could develop.<sup>7</sup> The section 272 safeguards are designed to enable regulators to detect and deter post-271 efforts by a BOC to leverage its local market power into competitive interLATA markets. These safeguards are clearly necessary so long as the BOC retains market power, because the BOC has incentives, *inter alia*, “to discriminate in providing exchange access services and facilities that its [long distance] affiliate’s rivals need to compete in the interLATA telecommunications services and information services markets.”<sup>8</sup> “This artificial advantage may allow the BOC affiliate to win customers even though a competing carrier may be a more efficient provider in serving the customer.”<sup>9</sup> The section 272 structural, accounting and nondiscrimination safeguards are targeted to detect and prevent such market power abuses and thereby to “ensure that competitors of the BOC’s [long distance] affiliate have access to essential inputs, namely, the provision of local exchange and exchange access services, on terms that do not discriminate against competitors and in favor of the BOC’s affiliate.”<sup>10</sup>

Local competition is declining in both Kansas and Oklahoma. SBC recently told Wall Street analysts and investors that it has significantly *reversed* its access line losses in 2003 in both states.<sup>11</sup> Specifically, Rayford Wilkins, SBC’s Group President of Marketing and Sales, told the investment community that “[c]onsistent with the reduction in retail access line loss has been a significant reduction in resale and UNEP lines in the West and Southwest. *In fact*,

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<sup>7</sup> *Non-Accounting Safeguards Order* ¶ 9 (“In enacting section 272, Congress recognized that the local exchange market will not be fully competitive immediately upon its opening.”).

<sup>8</sup> *Id.* ¶ 11.

<sup>9</sup> *Id.* ¶ 12.

<sup>10</sup> *Id.* ¶ 13.

<sup>11</sup> [http://www.shareholder.com/sbc/downloads/AnalystPres\\_nov03.pdf](http://www.shareholder.com/sbc/downloads/AnalystPres_nov03.pdf) at 8.

*Southwest has been negative on UNEP growth for two consecutive quarters.*<sup>12</sup> Thus, the data in the *FCC Local Competition Report* showing that total CLEC market share was only 11% in Oklahoma and only 17% in Kansas as of the end of 2002<sup>13</sup> materially overstates the extent of current local competition in those states.

SBC's claims to the contrary in this proceeding cannot withstand scrutiny. SBC asserts that "wireline competitors in its service area in Kansas already have achieved over a 28% market share, while in Oklahoma they have achieved an 18 percent market share."<sup>14</sup> No weight can be given to SBC's market share assertions, which are not based on public, verified data, but on SBC's self-serving and inaccurate "E 911" database analysis.<sup>15</sup> In stark contrast, SBC's recent statements to Wall Street analysts and investors admit that competitive carriers are actually *losing* market share.

In any event, the Commission has stressed that the section 272 rules should remain in place "until *facilities-based* alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary."<sup>16</sup> This makes sense because the BOC's ability anticompetitively to harm rivals is based on its control of the bottleneck network facilities that are necessary for the provision of interLATA services. The record is undisputed that there is no significant facilities-based alternative to SWBT's local exchange and access services in

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<sup>12</sup> CCBNStreetEvents, Event Transcript, SBC Communications Analyst Meeting, November 13, 2003, 1:30PM ET, appended hereto as Attachment 7 at 4 (emphasis added).

<sup>13</sup> FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition Status as of December 31, 2002*, June 2003 at Table 7.

<sup>14</sup> SBC at 3.

<sup>15</sup> In its filings in the Triennial Review proceeding, AT&T showed that the BOCs' attempts to derive competitive carrier market share using the E911 data base was irredeemably flawed and grossly overstated the extent of competitive entry. See AT&T Triennial Review Comments at 181-82, WC Docket No. 01-338, (filed July 17, 2002).

<sup>16</sup> *Non-Accounting Safeguards Order* ¶ 13 (emphasis added).

Oklahoma and Kansas.<sup>17</sup> To the contrary, competitive carriers remain highly dependent upon SWBT to provide local telephone services in both states, as well as to originate and terminate long distance and broadband services that they provide.

Certainly on the record in this proceeding the BOCs have failed to show that they lack market power and thus no longer have the incentive and ability to harm unaffiliated rivals in the long distance markets. SWBT's stray and unsupported claims of intermodal competition from VoIP and wireless falls far short of demonstrating that it no longer controls bottleneck facilities that are needed to provide long distance services.<sup>18</sup>

Unable to demonstrate that SWBT lacks market power, SBC reiterates the arguments it made in the *Texas Section 272 Extension Proceeding*, i.e., that SWBT has no incentive to abuse its dominance. According to SBC, "[a]ny attempt by a BOC to provide inferior service to other interexchange carriers – thereby creating inferior service for its local exchange customers – is more likely to alienate local exchange customers than win new interexchange customers."<sup>19</sup> As AT&T explained in its Petition, this argument makes no sense. It is flawed on multiple levels. First, the section 272 safeguards were designed, *inter alia*, to detect and prevent *price* discrimination such as when a BOC uses its above-cost access charges to price squeeze long distance rivals – something which does not "alienate" a BOC's local customers, but which can

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<sup>17</sup> AT&T Petition at 5-7, citing, *inter alia*, to FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition Status as of December 31, 2002*, June 2003, Tables 1, 3 & 4 (showing that 96 percent of all switched access lines are served directly by ILECs or by CLECs using ILEC-provided facilities to compete through resale or UNE-based services).

<sup>18</sup> SBC at 4. In this regard, even the BOCs' § 272 affiliates would currently be deemed dominant were it not for section 272 safeguards including the OI&M restrictions. The Commission is currently considering in another proceeding whether to deem the § 272 affiliates non-dominant even if § 272 safeguards have sunset, but whatever the outcome there, the Commission could not possibly find in this proceeding that not just the affiliates but the BOCs themselves lack market power.

devastate long distance competition. Second, a BOC can engage in non-price discrimination, by providing superior service to its long distance affiliate, while providing its rivals with minimally acceptable service. Again, such discrimination adversely affects a long distance competitor's customers, not the BOC's customers.

SBC, in its Comments, claims that these arguments “completely miss[] the mark” because “discrimination could only succeed in conferring market power on the BOC long distance affiliate if large numbers of customers adjusted their purchases as a result of it” and any attempt is bound to fail because the long distance carrier will be aware of it and complain to regulators.<sup>20</sup> However, the delay inherent in both identifying such discrimination<sup>21</sup> and collecting sufficient evidence to prove it<sup>22</sup> makes it difficult to both detect and deter such misconduct. The only effective alternative to structural separation is the substantially more onerous “burdensome regulatory involvement” that the Commission has expressly eschewed.<sup>23</sup>

**B. The Record Is Clear That SWBT Continues To Misallocate Costs And Discriminate Against Unaffiliated InterLATA Competitors.**

In its Petition, AT&T provided substantial evidence that SWBT and its sister-BOCs have cross-subsidized their long distance affiliates and discriminated against unaffiliated interLATA providers.<sup>24</sup> SBC derides such evidence as “half-baked,”<sup>25</sup> but the evidence of SBC's

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<sup>19</sup> SBC at 5.

<sup>20</sup> SBC at 6, n. 9.

<sup>21</sup> The discriminatory conduct would have to go on for a sufficient period of time so that it becomes apparent to end-users. Even then, a sufficient number of end users would have to complain to the carrier before it became apparent to the carriers as well.

<sup>22</sup> End users are reluctant to provide such evidence since to do so alienates the BOC -- the party from whom the end users must now receive the service because of the BOC's discriminatory conduct.

<sup>23</sup> *Third Order on Reconsideration* ¶ 20 (citing *Non-Accounting Safeguards Order* ¶ 163).

<sup>24</sup> AT&T Petition at 8-11.

<sup>25</sup> SBC at 7.

misconduct includes conclusive findings of federal and state regulators that SBC *has* discriminated against competitive carriers. These abuses have resulted in SBC having “been assessed fines, penalties, commitments, or refunds of over \$1.1 billion for violations of statutory obligations, merger conditions, and conditions of section 271 approvals at both state and federal levels.”<sup>26</sup> Overall, SBC has “been fined, ordered to make refunds, or compelled to enter consent decrees in more than 160 instances since September 1996.”<sup>27</sup> This pattern of anticompetitive conduct reflects SBC’s admitted policy of trying to “make our welcome mat smaller than anyone else’s.”<sup>28</sup>

Notably, as Sprint documented in the *Texas Section 272 Extension Proceeding*, many of these fines were imposed as a result of SBC’s attempts to discriminate against rivals and thwart competition on the merits.<sup>29</sup> And, if anything, these problems are growing worse. For example, SBC was fined more than \$26 million for violating the SBC-Ameritech merger conditions, including fines for “willfully and repeatedly” violating provisions by causing delays and “forc[ing] competing carriers to expend time and resources in state proceedings trying to obtain what SBC was already obligated to offer.”<sup>30</sup>

And no amount of spinning by SBC can explain away the results of its biennial audit. Despite conducting a bare-bones audit that failed to evaluate rigorously SBC’s compliance with section 272,<sup>31</sup> the audit confirms pervasive discrimination by SBC in Kansas and Oklahoma, in

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<sup>26</sup> Comments of Sprint Corporation (“Sprint”), Attachment 1 at 12.

<sup>27</sup> *Id.* at 12 n.27.

<sup>28</sup> Peter Burrows, *Telecommunications Pick of the Litter: Why SBC is the Baby Bell to Beat*, Business Week (March 6, 1995).

<sup>29</sup> Sprint, Attachment 1 at 13-14.

<sup>30</sup> *Forfeiture Order*, ¶ 1.

<sup>31</sup> Even SBC concedes that the audit was not conducted under an attestation standard, but rather a much weaker “agreed-upon procedures” standard. See SBC at 8, n.15. Thus the SBC audit

clear violation of section 272. Although SBC acknowledges that the audit shows that in many instances it provided competitors with inferior performance relative to its own long distance affiliate, it contends that in some months the data show SBC performed better for competitors than its own affiliate and, therefore, “the[] data do not show any pattern of discrimination whatsoever.”<sup>32</sup> That is clearly not the case with regard to the critical measures cited by AT&T in its Biennial Audit Comments and in this Petition. For example, SBC’s return of firm order confirmations on DS1 and DS3 facilities were *consistently* longer for SBC’s rivals than for its affiliates in both Kansas and Oklahoma.<sup>33</sup> SBC’s competitors similarly *consistently* suffered longer delays than SBC’s affiliates did in restoring services after a trouble was reported.<sup>34</sup> This discrimination persisted into the second section 272 audit report released on December 17, 2003.<sup>35</sup> Again, month after month, SBC’s return of firm order confirmations on all facilities were *consistently and materially* longer for SBC’s rivals than for its affiliates in both Kansas and Oklahoma.<sup>36</sup> SBC’s competitors similarly *consistently* suffered longer delays than SBC’s affiliates did in restoring services after a trouble was reported.<sup>37</sup>

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cannot be relied upon to show SBC’s compliance with section 272 and, as shown by Dr. Bell’s declaration appended to AT&T’s Comments on that audit, the data shows discrimination and is statistically significant. Comments of AT&T Corp. on SBC’s Section 272 Compliance Biennial Audit Report, CC Docket No. 96-150 (filed Jan. 29, 2003), Bell Decl. ¶¶ 45-72.

<sup>32</sup> SBC at 9.

<sup>33</sup> See SBC’s First Section 272 Audit, Attachment A-7 at 1: Performance Measurement No. 1 (“Successful Completion According to Desired Due Date”).

<sup>34</sup> See *id* at 6-7: Performance Measurement Nos. 4 (“Time to Restore and trouble duration”) and 5 (“Mean time to clear network/average duration of trouble.”)

<sup>35</sup> Section 272 Biennial Report for SBC Communications, Inc., EB Docket No. 03-199.

<sup>36</sup> See SBC’s Second Section 272 Audit, Attachment A-7 for Performance Measurement No. 1 (“Successful Completion According to Desired Due Date”) at 1 and 4 (for Kansas) and 2 and 5 (for Oklahoma).

<sup>37</sup> See *id* for Performance Measurement No. 4 (“Time to Restore and trouble duration”) for DS0 service at 38 and 44 (for Kansas) and 40 and 47 (for Oklahoma).

Finally, SBC claims that evidence showing that it is discriminating against rival long distance carriers is irrelevant because it shows only that violations took place despite the existence of “structural separation.”<sup>38</sup> That is false. The above-discussed evidence conclusively shows that SBC has both the incentive and ability to abuse its bottleneck monopolies to impair long distance competition. Section 272, when properly and vigorously enforced, can be an important tool for regulators and rivals to detect BOC anticompetitive conduct. *See infra* Part II.C. The fact that discrimination occurred despite such safeguards demonstrates that regulators should take decisive and prompt action to punish such violations and to extend and strengthen the safeguards to ensure that regulators and competitors can continue to rely on those tools to detect future discrimination by SWBT and other BOCs. Indeed, the existing evidence of SWBT’s persistently discriminatory conduct, despite section 272 safeguards, is powerful evidence that it would undertake a broader array of anticompetitive practices if these “crucial[ly] important[.]” safeguards were gutted, as SBC now urges. Indeed, that the BOCs have fought so hard to eliminate these safeguards is itself probative of the fact that they view them as constraining their ability to exploit fully their market power.

## **II. SBC FAILS TO OFFER ANY PLAUSIBLE JUSTIFICATION FOR SUNSETTING CORE SECTION 272 SAFEGUARDS**

### **A. The Commission’s Decision To Allow The Section 272 Safeguards To Sunset in New York and Texas Does Not Provide A Basis For Eliminating Such Obligations On SWBT In Kansas and Oklahoma.**

SBC argues that the Commission should allow SWBT’s section 272 obligations to sunset in Kansas and Oklahoma because the Commission allowed section 272 obligations to sunset in New York and Texas.<sup>39</sup> The short answer is that the Commission’s decisions to sunset the rules

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<sup>38</sup> SBC at 8.

<sup>39</sup> SBC at 2. SBC suggests that the Commission should, as it did in Texas and New York, permit SWBT’s “section 272 obligations to sunset by operation of law and ... defer[] all broader policy

in those states failed to disclose the Commission's rationale for the actions it took, and therefore can have no precedential value herein.<sup>40</sup>

Moreover, both the New York and Texas markets have more local competition than either Kansas or Oklahoma. SBC itself claimed in the *Texas Section 272 Extension Proceeding* that Texas is “one of the most competitive states in the country,”<sup>41</sup> certainly more than Kansas and Oklahoma. Similarly, New York has more local competition than either Kansas or Oklahoma.<sup>42</sup> Thus, even if it had been proper to allow Section 272 to sunset in New York and Texas (and it was not), it certainly is not proper here.

**B. SBC's Claims That Section 272 Safeguards Are Too Costly Are Contrary To Theory And Fact.**

1. The Evidence in the *OI&M Proceeding* Shows that Carriers Like BellSouth Incurred Only Minimal Costs in Complying with Section 272. Any SBC or Verizon Claim of Higher Costs Reflects Inefficiency or Methodological Errors

SBC claims that the section 272 safeguards should be eliminated because the costs of structural separation exceed its benefits.<sup>43</sup> In making that claim, SBC relies on its and Verizon's assertions about the costs of section 272 safeguards, particularly those related to the prohibition

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issues to its *Sunset FNPRM* proceeding.” SBC at 1. But if the Commission permits SWBT's section 272 obligations to sunset by operation of law, the Commission's actions conclusively eliminate the § 272 safeguards in Kansas and Oklahoma regardless of the outcome of the *Sunset NPRM* proceeding. Verizon also incorrectly argues that AT&T “is advocating a general rule that would apply everywhere” Verizon at 2. As shown in AT&T's petition herein, it is the absence of viable local competition in Kansas and Oklahoma that motivated the filing, and compel the granting, of AT&T's Petition.

<sup>40</sup> As noted in AT&T's Petition at 2, n.2, AT&T has appealed the Commission's decisions to allow Section 272 to sunset in New York and in Texas because, as the published dissents make clear, the Commission's decisions are arbitrary and capricious, devoid of either explanation or response to the comments and evidence it solicited.

<sup>41</sup> SBC at 2-3.

<sup>42</sup> *Texas Section 272 Extension Proceeding* at 7; Sprint, Attachment 1 at 5-6.

<sup>43</sup> SBC at 10-13.



of sharing operation, installation and maintenance services.<sup>44</sup> However, in the OI&M proceeding SBC and Verizon offered nothing more than *ipsi dixit* to support their assertion.<sup>45</sup> Both Verizon and SBC have had several opportunities to provide hard evidence to support their claims, and their repeated failure to do so, even under a Protective Order, speaks volumes about their inability to do so.

Moreover, SBC's and Verizon's claims that the section 272 structural safeguards, including the OI&M rules, will cost it hundreds of millions of dollars during the period in which section 272 applies to their operations,<sup>46</sup> is undercut by the admission of other BOCs that the costs are nowhere near that high. BellSouth, for example, submitted evidence showing that the absolute cost of OI&M services for its long distance operations, which provide services to about 3 million subscribers, is \$3.3 million a year – or about 9 cents per month for each of BellSouth's customers. This tiny amount explains fully why the BOCs, including SBC, have been able to compete in – and in some cases already dominate – the long distance markets without the slightest competitive handicap imposed by the OI&M rules. SBC's absurd assertions that it incurs hundreds of millions of dollars in costs are thus not costs that are caused by the section 272 safeguards, but rather are the result of either gigantic errors in its methodology for accounting for such costs (which SBC has never adequately disclosed) or its own choices

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<sup>44</sup> See SBC at 11. However, as AT&T previously explained, the Verizon declarations are little more than conclusory statements that opine generally about costs, without any specific discussion of how those costs were derived and without any backup material that could be used to verify independently these claims. See AT&T 272 Sunset Reply Comments at 18, WC Docket No. 02-112 (filed Aug. 26, 2002).

<sup>45</sup> See Letter from Aryeh Friedman, Senior Attorney, AT&T, to Marlene Dortch, Secretary, Federal Communications Commission, October 22, 2003, filed in the *SBC OI&M Proceeding* at 4-5; Letter from C. Frederick Beckner, on behalf of AT&T, to Marlene Dortch, Secretary, Federal Communications Commission, July 9, 2003 filed in the *Verizon OI&M Proceeding*.

<sup>46</sup> SBC OI&M Petition, filed January 5, 2003 at 20 (over \$77 million per year); Letter from Kathryn C. Brown, Senior Vice President, Verizon, to Commissioner Jonathan S. Adelstein, October 31, 2003 at 2 (\$183 million from 2003 through 2006).

regarding how to structure its long distance operations – which, if its figures are correct, simply demonstrate that SBC has made grossly inefficient decisions relative to the other BOCs.

2. SBC Has Told Wall Street Analysts And Investors That It Can Fully Compete For All Customers, Including Enterprise And Broadband Customers, Under The Current Regulatory Regime

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Despite SBC's claims that it is hobbled by section 272, its long distance offerings continue to enjoy unprecedented success. Indeed, SBC has told Wall Street analysts and investors precisely the opposite of what it is now telling the Commission. Specifically, on November 13, 2003, SBC boasted to the investment community that it could compete and succeed in all markets, including the enterprise and broadband markets, under the current regulatory regime. Specifically, SBC boasted that:

- “We’ve added 4.1 million consumer lines in the first three quarters of 2003 compared to 900,000 in all of 2002. In fact, every quarter this year, we’ve delivered the best combined consumer and business long distance numbers of any RBOC, and our second quarter was the best ever by a regional Bell. As you look at our penetration rates, we’ve achieved 32% in the consumer market in California in just nine months and 54% in *Southwest in just over three years.*”<sup>47</sup>
- “Now let’s take a quick look at medium business. Again, our existing relationships give us an advantage. *We have a dominant share of local voice ....* As for results, our growth rates in medium business *far exceed the market norms in important areas like frame relay and dedicated Internet access.*”<sup>48</sup>

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<sup>47</sup> CCBNStreetEvents, Event Transcript, SBC Communications Analyst Meeting, November 13, 2003, 1:30PM ET, appended hereto as Attachment 7 at 4 (emphasis added).

<sup>48</sup> *Id.* at 5 (emphasis added).

- Now let's talk about enterprise ... [w]e have a *dominant share in local voice*, and that means that for years we've had a long-term relationship with many of these businesses. In fact, 244 of the Fortune 500 are headquartered in our footprint ... this is really a *sweet spot* for SBC and *reflects our capabilities and infrastructure today*.”<sup>49</sup>
- “As you know, enterprise customers absolutely require things ... and SBC can deliver them all. *And we deliver them today*.” “[For example,] we recently closed a \$350 million, 5 year contract for a nationwide frame-relay network ... [a]nother example: a \$9 million, 3 year contract ... [that] requires a 580 site frame relay network. Two more: a \$10 million, 3 year contract ... includes a 221 site frame relay network ... [a]nd finally, we closed a \$10 million contract which includes a 104 site frame relay network.”<sup>50</sup>

The accuracy of SBC's representations to Wall Street about its success in the market is demonstrated by SBC's current market share. Indeed, even SBC admits that it has market power when it reported that it has between 50% and 60% of the residential interLATA long distance market share in Oklahoma and Kansas.<sup>51</sup> Thus, SBC is now, by a wide margin, the *largest* residential long distance provider in Kansas and Oklahoma. These facts simply cannot be squared with SBC's claim herein that section 272 puts the RBOCs at a “competitive disadvantage[.]”<sup>52</sup>

### 3. The Commission Has Already Minimized the Burden on the BOCs

Finally, SBC ignores the fact that the Commission has loosened many of the restrictions that SBC is complaining about. As to SBC's claim that the BOCs are “severely restricted in their

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<sup>49</sup> *Id.* at 6 (emphasis added).

<sup>50</sup> *Id.* at 7 (emphasis added).

<sup>51</sup> [http://www.shareholder.com/sbc/downloads/AnalystPres\\_nov03.pdf](http://www.shareholder.com/sbc/downloads/AnalystPres_nov03.pdf) at 10.

<sup>52</sup> SBC at 12.

offerings of competitive bundled services,”<sup>53</sup> the Commission has largely eliminated restrictions on bundling, even by dominant carriers like SBC.<sup>54</sup> Thus, SBC and the other RBOCs today offer customers a broad array of bundled offerings, including combinations of local, long distance, data and wireless.<sup>55</sup> Indeed, SBC’s recent briefing to Wall Street analysts and investors states that “the key, of course, to our strategy is to bundle ....These charts tell the story – 68% of all of our customers held some form of bundle.”<sup>56</sup>

Similarly, the Commission’s orders implementing section 272 already have provided numerous opportunities for SBC and its 272 affiliates to share services and take advantage of other economies.<sup>57</sup> Even though these joint activities present risks of anticompetitive behavior, and could also easily have been prohibited entirely, the Commission permitted such activities, which substantially reduced the BOCs’ costs of compliance with section 272. Although SBC complains (without any hard evidence or supporting declaration) that even these reduced obligations are too burdensome,<sup>58</sup> the fact is that the BOCs have been able to capture

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<sup>53</sup> *Id.*

<sup>54</sup> *See generally Bundling Order.*

<sup>55</sup> *See, e.g.,* [http://www01.sbc.com/Products\\_Services/Residential/1,,616--6-3-1,00.html](http://www01.sbc.com/Products_Services/Residential/1,,616--6-3-1,00.html) (SBC’s bundled offering).

<sup>56</sup> CCBNStreetEvents, Event Transcript, SBC Communications Analyst Meeting, November 13, 2003, 1:30PM ET, appended hereto as Attachment 7 at 4. *See also* at 5: “As you add additional products to the bundle the impact on retention is enormous. Long distance alone reduces the rate of churn by 9%, DSL lowers the churn by 61%, and put the two together and you’ve cut churn by 73%.”

<sup>57</sup> *See, e.g.,* WorldCom 272 Sunset Comments at 7-9, WC Docket No. 02-112 (filed Aug. 5, 2002) (“WorldCom 272 Sunset Comments”); Time Warner 272 Sunset Comments at 17-20, WC Docket No. 02-112 (filed Aug. 5, 2002).

<sup>58</sup> *See, e.g.,* SBC at 12, complaining that “section 272 requires the BOC to share, on a nondiscriminatory basis, any BOC information that it shares with its section 272 affiliate.”

unprecedented dominant market shares using affiliates that have only a small fraction of the employees of established long distance carriers.<sup>59</sup>

**C. The Existence Of Other Regulatory Protections Is Not A Reason To Sunset Section 272**

Finally, SBC renews its argument that, despite Congress' decision to impose detailed structural, accounting and transactional safeguards in section 272, the benefits provided by those safeguards are minimal, and can be obtained instead by relying on other provisions of the Act and Commission rules.<sup>60</sup> These claims are entirely meritless. Indeed, given that most of the rules that SBC cites were in effect in 1996, Congress would not even have enacted section 272 if it believed those rules could be effective in policing the BOCs' misconduct and eliminating discrimination and cost misallocation. Rather, section 272, when properly implemented and vigorously enforced, provides substantial and unique benefits that promote competition in telecommunications markets.

In particular, the state commission comments previously filed in this docket confirm the enormous value of the section 272 safeguards in detecting, deterring and remedying BOC misconduct. Thus, as the Texas PUC concluded, if section 272 safeguards are eliminated, regulators "will lose a valuable means to ensure [the BOC's] compliance with its obligations to provide access to the local exchange and exchange access markets that [the BOC] controls."<sup>61</sup> The Missouri Public Service Commission reports that "without the section 272 audit process,

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<sup>59</sup> See WorldCom 272 Sunset Comments at 8; *see also* AT&T 272 Sunset Reply Comments, Selwyn Reply Dec ¶¶ 6-8.

<sup>60</sup> SBC at 7-8; *see also* Verizon at 5.

<sup>61</sup> Texas PUC 272 Sunset Comments at 3; *see also* Washington UTC 272 Sunset Comments at 3, WC Docket No. 02-112 (filed Aug. 5, 2002).

there is no way to detect and deter discrimination and anti-competitive behavior.”<sup>62</sup> Further, the Pennsylvania Public Utilities Commission reports that the separate structure and accounting provisions of section 272 “assist[] the PA PUC in its ability to design rates,” and the “ability to readily identify costs and revenues from the business segment is *critical* to ongoing rate review.”<sup>63</sup> And more generally, the Pennsylvania commission asserts that the collapse of separate affiliate requirements would “perpetuate[] what appears to be a continual reduction in available information.” *Id.* at 4. As these comments show, section 272 provides unique, pro-competitive benefits that, contrary to the BOCs’ claims, cannot be obtained from other existing rules and provisions of the Act.<sup>64</sup>

In all events, the Commission itself recently rejected the argument that its existing safeguards are a more effective and less costly mechanism for preventing discrimination than structural separation. In the *SBC-Ameritech Merger Order*, the Commission determined that adopting the proposed separate affiliate structure benefited competition because “reliance on existing regulatory safeguards is misplaced.”<sup>65</sup> That is because even though the Commission “issues rules to prevent discrimination,” it is “impossible for the Commission to foresee every

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<sup>62</sup> Missouri PSC 272 Sunset Comments at 4, WC Docket No. 02-112 (filed Aug. 5, 2002); *see also* Washington UTC 272 Sunset Comments at 3 (“maintaining a separate affiliate makes the audit process easier and provides more transparency to the transactions to be audited”); Pennsylvania PUC 272 Sunset Comments at 4, WC Docket No. 02-112 (filed Aug. 5, 2002) (“audits can produce useful information for policymakers such as the PUC”).

<sup>63</sup> Pennsylvania PUC 272 Sunset Comments at 5.

<sup>64</sup> In this regard, SBC relies heavily on the pro-competitive safeguards found in section 251(g) and in section 251(c), which it asserts will continue to apply and protect competition after section 272 is allowed to sunset. *See* SBC 272 Sunset Comments at 7. But that claim is disingenuous, because SBC and the other BOCs have vigorously contended in other Commission proceedings that the Commission’s requirements under those sections should be eliminated or at least drastically cut back.

<sup>65</sup> *Ameritech-SBC Merger Order* ¶ 206.

possible type of discrimination.”<sup>66</sup> Accordingly, the Commission found that “SBC’s offer to establish a separate subsidiary for advanced services is directly responsive” to concerns regarding the Commission’s ability to detect discrimination – but achieves that goal in a way that avoids “engaging in detailed regulatory oversight.”<sup>67</sup>

### CONCLUSION

For the foregoing reasons, the Commission should issue a rule extending application of section 272 to SWBT in Kansas and Oklahoma for an additional three years.

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December 29, 2003

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<sup>66</sup> *See id.* ¶ 220.

<sup>67</sup> *Id.* ¶ 211.

**CERTIFICATE OF SERVICE**

I hereby certify that on this 29<sup>th</sup> day of December, 2003, I caused true and correct copies of the foregoing Reply Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: December 29, 2003

/s/ Theresa Donatiello-Neidich  
\_\_\_\_\_  
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